

1 **REBUTTAL TESTIMONY OF**

2 **JIMMY E. ADDISON**

3 **ON BEHALF OF**

4 **SOUTH CAROLINA ELECTRIC & GAS COMPANY**

5 **DOCKET NO. 2012-218-E**

6

7 **Q. PLEASE STATE YOUR FULL NAME FOR THE RECORD.**

8 A. My name is Jimmy E. Addison.

9 **Q. ARE YOU THE SAME JIMMY ADDISON WHO HAS**
10 **PREVIOUSLY FILED DIRECT TESTIMONY IN THIS DOCKET?**

11 A. I am.

12 **Q. WHAT IS THE SUBJECT OF THIS REBUTTAL TESTIMONY?**

13 A. The purpose of this rebuttal testimony is to respond to certain points
14 raised by The South Carolina Energy Users Committee’s witness, Mr.
15 Kevin O’Donnell, in his testimony concerning a) the appropriate return on
16 equity (“ROE”) for the Company, and b) the appropriate capital structure
17 for use in measuring the cost of capital for the Company. My testimony
18 also responds to the testimony of the AARP’s witness, Mr. Ralph Smith,
19 concerning SCE&G’s electric weather normalization adjustment or eWNA.

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1 **Q. HOW DO YOU RESPOND TO MR. O'DONNELL'S SUGGESTION**
2 **CONCERNING AN APPROPRIATE ROE FOR SCE&G?**

3 A. Mr. O'Donnell suggests that the Commission establish an ROE for
4 SCE&G of 9.5%. As CFO of SCE&G and SCANA, I am familiar with the
5 reasonable expectation of investors in SCANA's stock and SCE&G's
6 bonds. I am also familiar with the financial ratios and other metrics that
7 will be necessary for SCE&G to retain its investment grade debt rating.
8 Based on this information, Mr. O'Donnell's recommended ROE does not
9 pass the test of practical reasonableness and market expectations. It is not
10 sufficient to attract investors to SCANA stock and SCE&G bonds on
11 reasonable terms or to allow SCE&G to raise the capital it needs in national
12 markets. With rates set at the returns Mr. O'Donnell proposes, it would not
13 be possible for SCE&G to maintain an investment grade rating on its senior
14 secured debt. Therefore, it would also not be possible for SCE&G to
15 finance its future capital needs, including the investment in the new nuclear
16 units, on reasonable terms, assuming that SCE&G would have access to the
17 required capital at all. For those reasons, Mr. O'Donnell's recommended
18 ROE, if adopted, would put the Company at serious financial risk.

19 **Q. PLEASE EXPLAIN.**

20 A. The credit rating agencies that monitor the creditworthiness of
21 SCE&G's debt understand that SCE&G is in a sensitive financial position
22 as a result of the capital requirements it faces in building the new nuclear

1 units. The agencies believe that these requirements are manageable
2 because a) the construction program is proceeding within expectations, b)
3 the BLRA provides a sound regulatory framework for financing the Units,
4 and c) regulatory and political support for nuclear construction remains
5 constructive in South Carolina. However, as to both the project and the
6 Company, these agencies, to quote Moody's Investor Services, "view the
7 outcome of the base rate case [i.e., this proceeding] as an important bell-
8 wether of the PSC's continuing support."¹ The agencies have signaled that
9 "SCE&G's ratings could be downgraded" if there was "a material reduction
10 in the utility's non-Summer returns [i.e., the ROE allowed in this case]."²
11 Mr. O'Donnell's proposed rate of return of 9.5%, as compared to SCE&G's
12 currently approved 10.7% ROE or the recently-approved 10.5% ROE
13 granted to Duke Energy Carolinas, LLC, would be a "material reduction in
14 the utility's non-Summer returns" such as Moody's cautioned. An ROE set
15 at that level would signal a fundamental change in the Company's
16 regulatory posture and ability to execute its financial plan.

17 I agree with the analysis presented by the Company's witness, Mr.
18 Hevert, demonstrating the methodological flaws in Mr. O'Donnell's ROE
19 analysis. However, my conclusion that Mr. O'Donnell's suggested ROE

¹ Moody's Investor Services, Credit Opinion: South Carolina Electric & Gas Company, September 14, 2012.

² Id.

1 would put the Company at serious financial risk is not based on a
2 theoretical analysis but on my direct, firsthand knowledge of SCE&G's
3 financial plan, the role that reasonable levels of future earnings play in that
4 plan, and the way that the investment community and rating agencies view
5 the importance of a reasonable ROE for SCE&G in light of the risks facing
6 the Company. An ROE set at the level suggested by Mr. O'Donnell would
7 seriously compromise the Company's ability to successfully execute its
8 financial plan over the next two years. It is during this time that the
9 Company will be required to raise approximately \$2 billion in market
10 capital. An ROE set at the level suggested by Mr. O'Donnell would not
11 allow the Company to maintain the financial ratios that are critical
12 indicators to the financial community of the Company's creditworthiness.
13 Furthermore, an ROE set at the level suggested by Mr. O'Donnell would
14 signal a dramatic change in the regulatory environment in South Carolina at
15 this critical stage of the Company's financing of the new nuclear Units.

16 **Q. HOW DO YOU RESPOND TO MR. O'DONNELL'S SUGGESTION**
17 **THAT THE COMMISSION SHOULD USE SCANA'S CAPITAL**
18 **STRUCTURE IN SETTING RATES FOR SCE&G?**

19 A. Using SCANA's capital structure in place of SCE&G's has no
20 support in logic, or established Commission practice. As to established
21 regulatory practice, this Commission has consistently used SCE&G's
22 capital structure in setting SCE&G's rates in past rate cases. As to SCANA

1 and its financial history, SCANA has a different capital structure than
2 SCE&G because it is a different business with different risks. The
3 difference in capital structure between SCE&G and SCANA is due almost
4 entirely to the additional leverage SCANA took on as part of its acquisition
5 of PSNC in 2001. SCE&G was not a part of that transaction and SCE&G
6 had no role or business relationship to that transaction. Therefore, there is
7 no factual basis to allocate SCANA's additional leverage to SCE&G.

8 Furthermore, SCE&G's higher level of equity and stronger capital
9 structure is reflected in SCE&G's credit ratings and interest rates, both of
10 which are more favorable than SCANA's as a result. The higher ratio of
11 equity to debt in SCE&G's capital structure is the basis for these lower
12 costs of debt which are reflected in SCE&G's electric rates. If applied to
13 SCE&G, SCANA's capital structure would not support SCE&G's cost of
14 debt. From a regulatory standpoint, there is no logic or equity in setting
15 rates using SCE&G's lower cost of debt while computing SCE&G's
16 weighted average cost of capital using a capital structure that does not
17 support those lower debt costs. To do so would mismatch costs and
18 benefits.

19 **Q. DOES SCANA'S MORE LEVERAGED CAPITAL STRUCTURE**
20 **HURT SCE&G'S CUSTOMERS IN ANY WAY?**

21 A. No, to the contrary, customers benefit from it. As discussed above,
22 customers benefit from SCE&G's less leveraged structure in the form of

1 lower interest rates on SCE&G's debt. The additional leverage SCANA
2 took on when it acquired PSNC allowed SCANA not to issue additional
3 shares of stock for that transaction. This limited the dilution of earnings per
4 share and shareholders' interests as a result of that transaction and therefore
5 increased the value of SCANA's stock going forward. As a result, when
6 equity is needed today at the SCE&G level, SCANA can issue fewer shares
7 to generate the amount of equity that it then provides to SCE&G to meet its
8 capital needs. Issuing fewer shares means less dilution. Because dividend
9 requirements are lower, more internally generated capital can remain in
10 SCE&G to meet its capital needs and strengthen its financial ratios. For
11 those reasons, SCE&G customers benefit when the sale of SCANA stock
12 generates more capital per share sold.

13 **Q. AS A PRACTICAL MATTER, WHAT WOULD BE THE EFFECT**
14 **OF ADOPTING MR. O'DONNELL'S SUGGESTION AS TO**
15 **SCE&G'S CAPITAL STRUCTURE?**

16 A. SCE&G's rating agencies recognize that during the next several
17 years SCE&G's financial ratios will be under stress as a result of the capital
18 it must raise to support nuclear construction. SCE&G will have to manage
19 its revenues and finances very carefully to maintain a favorable credit rating
20 for its first mortgage bonds during this period. Setting rates for SCE&G
21 based on the SCANA capital structure would make maintaining financial
22 ratios that support current credit ratings impossible. In my opinion, and

1 given my knowledge of SCE&G's current financial plan, revenues set
2 based on the SCANA capital structure would not support the coverage
3 ratios required to maintain a favorable rating for SCE&G's debt. As a
4 result, SCE&G's financial plan for the coming years would be substantially
5 impaired. It is also my opinion, based on my knowledge of how SCE&G is
6 perceived, that the financial community would see the shift to SCANA's
7 capital structure for rate making purposes as a departure from established
8 regulatory practice in setting rates for SCE&G. Given the lack of any
9 logical basis for such a shift, the financial community would be likely to
10 see it as a sign of a change in regulatory climate. This would add
11 substantive qualitative concerns to the quantitative issues as to financial
12 ratios that this approach would raise.

13 **Q. HOW DO YOU RESPOND TO MR. SMITH'S SUGGESTION THAT**
14 **THE COMMISSION SHOULD TERMINATE THE eWNA?**

15 A. SCE&G would urge the Commission to maintain the eWNA as
16 presently provided for in Order No. 2010-471. The eWNA is functioning
17 as intended to give customers more stable and predictable bills and to
18 eliminate volatility from the Company's revenues that creates inefficiency
19 and uncertainty in our operations.

20 **Q. PLEASE EXPLAIN HOW THE eWNA FUNCTIONS.**

21 A. The eWNA adjusts the electric rate that SCE&G charges customers
22 on a monthly basis to ensure that the Company neither over-collects nor

1 under-collects its fixed cost of providing service based on weather
2 conditions. As a result, customers' bills are less sensitive to weather and do
3 not vary as much up or down. The eWNA also prevents SCE&G's electric
4 revenues from varying as much up or down based on weather, and there are
5 important benefits to the Company and its customers from the efficiencies
6 that come from a more predictable stream of revenue.

7 **Q. WHY ARE PREDICTABLE ELECTRIC REVENUES**
8 **IMPORTANT?**

9 A. Unpredictable shortfalls or surpluses in the cash generated from
10 operations month-to-month leads to inefficiency in the operation of our
11 business. More predictable electric revenues allow the Company to better
12 manage its cash flow, to reduce its borrowing to cover shortfalls as they
13 occur, and to better budget knowing that cash will be available to meet
14 budgeted expenditures. Taking weather variability out of our revenue
15 stream makes our financial performance more transparent. Anyone looking
16 at our revenues or any of our financial ratios related to revenues can see
17 those results without the effects of weather-related variations that mask the
18 true picture.

19 **Q. WHAT HAS THE EFFECT OF eWNA BEEN ON CUSTOMERS'**
20 **BILLS SINCE IT WAS PUT IN EFFECT?**

21 A. Since eWNA was put in effect in 2010, and up through September of
22 2012, SCE&G has collected revenues that were \$53 million less than what

1 it would have collected absent eWNA. This has been a direct benefit to
2 customers and a direct loss of revenues to SCE&G. In addition, in the
3 settlement agreement that the Commission approved in Order No. 2010-
4 471, SCE&G agreed to rebate to customers \$25 million in weather-related
5 revenue, which was the approximate amount that SCE&G would not have
6 charged customers if the eWNA mechanism had been in place during early
7 2010. In addition, as anticipated in Order No. 2010-471, the billing of this
8 rebate to customers resulted in an over rebate, the amount of which is \$2.0
9 million. All told, the customers have been provided a benefit of \$80
10 million in reduced billings as a result of the eWNA to date. The benefit per
11 customer would be approximately \$126.

12 **Q. IF THE eWNA WERE TO BE TERMINATED, AS MR. SMITH HAS**
13 **SUGGESTED WOULD YOU AGREE WITH MR. SMITH THAT**
14 **THESE FUNDS SHOULD BE RECOVERED?**

15 A. Yes. As Mr. Smith has testified, if the eWNA is terminated, the
16 amounts foregone should be recovered. We do not support terminating the
17 eWNA, and believe that doing so would be a mistake. However, if the
18 Commission were to terminate the program, we would ask that the net
19 savings provided to customers be amortized by special rate rider over a
20 period equal to the number of months during which those savings were
21 provided. The eWNA was implemented in the first billing cycle of August

1 2010 so it would have been in effect for 29 months at the date that rates
2 approved in this proceeding go into effect.

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

4 A. Yes. It does.